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TAGS: ECON PGOV PREL ENRG EPET EINV BL EFIN
SUBJECT: TREASURY VISIT: BOLIVIA'S ECONOMIC FORECAST

Classified By: EcoPol Chief Mike Hammer for reasons 1.4 (b) and (d).

Summary

¶1. (C) On June 9-10, Marie Ewens, International Economist at the Treasury Department visited La Paz. In meetings with representatives across the financial sector, four general themes emerged. First, large international reserves and a fiscal surplus will allow Bolivia to withstand any foreseeable financial crisis. Second, long-term growth is severely threatened by a complete lack of investment in the productive sector. Third, inflation will remain high over the next several years, but the severity of its impact on the Morales administration is not clear. Fourth, no consistent economic strategy has emerged from the administration and both economic policy and management suffer from the incompetence, inexperience, and politicization of the bureaucracy. End Summary.

Financial Crisis Not a Threat to Bolivia

¶2. (C) The Morales administration is blessed to be governing in bonanza times for Bolivia. The three principal areas of export production (gas, mining, and agriculture) are all enjoying historically high prices. For example, in the principal gas export contract with Brazil the price has risen from around one dollar per million cubic meter of gas in 2000 to the current price of $5.40. Combined with higher tax rates, international prices have led to a windfall for the national treasury. Central Bank President Raul Garron said that reserves would cross the seven billion dollar mark in mid-June. That is equivalent to some 70 percent of Bolivia's gross domestic product. Moreover, Oscar Navarro, who recently resigned his position as Vice Minister at the Ministry of Treasury, reported that while the budget surplus fell from 4 percent in 2006 to 1.7 percent in 2007, the budget was likely to remain in surplus in 2008. The International Monetary Fund's representative Steven Vesperoni seconded the positive outlook for the Bolivian macro economic situation, adding that while public spending was growing at

between 10-15 percent a year, revenue growth was greater and the budget would remain in surplus. The general consensus is that Bolivia could withstand almost any financial shock.

No Investment in the Productive Sector

¶3. (C) Another consensus opinion is that Bolivia suffers from a severe lack of investment in productive assets. The President of Association of Private Bankers (ASOBAN) reported that banks have placed no new loans for new productive sector projects, the only investments taking place are to maintain current operations. Economists from the Millennium Foundation (a Bolivian economic think tank) said that total net investment in 2007 was only $168 million. They claimed that private investment had fallen 40 percent from 2006, whereas in the region investment was some 60 percent higher. The Bolivia Director of the Andean Development Bank (CAF) placed private investment at around 5 percent of GDP, and added that in the late 1990s that figure had been around 20 percent. While times may be good in Bolivia at the moment, future production (and prosperity) is ominously threatened by lack of investment. Moreover, the Morales administration is taking no positive steps to reverse the trend.

Inflation Will Remain High: Government Sees It As an "Acceptable Threat"

¶4. (C) In general, there was a consensus that inflation would remain in double digits for the next 2-3 years (currently inflation is on pace to reach 17 percent this year). While a concern for the government, the economists we met generally thought that inflation would not be enough to cause the Morales administration to fall. Indeed, at the Millennium Foundation, they believed that the government has a certain tolerance towards inflation as an acceptable consequence of continual state expansion. This view was supported by comments made by Central Bank President Garron who explained the Morales administration view towards inflation as being an "acceptable threat". In general, they believe that inflation is a world phenomena derived principally from elevated food costs (Note: Bolivia recently changed the basket of goods used to measure inflation. The new basket discounts the weight of food by raising the number of goods in the basket from some 150 to 350. It is the first adjustment in the basket of goods since 1991. According to the Millennium Foundation inflation in May would have been 2.3 percent using the old basket, whereas the official May rate was 1.7 percent. End note).

¶5. (C) Garron went on to hint at a tense Central Bank relationship with Treasury, but reiterated his belief in the importance of maintaining Central Bank independence. (Note: When Garron left the room briefly, his economic and legal advisors gave him great personal credit for having negotiated and worked with the Morales administration to both carry out necessary Central Bank functions while appeasing administration demands. They said that without Garron's personal touch, the Central Bank would in all likelihood now be dominated by Movement Toward Socialism (MAS) loyalists and have little independence. End note).

¶6. (C) The Central Bank has been criticized by some for not increasing the value of the currency (the boliviano) sufficiently versus the dollar. Garron defended the Central Bank's policies by saying that he felt that Bolivia's productive sector was too "shallow" to sustain a sharp increase in the currency (unlike in Brazil). He has tried be very deliberate, predictable, and moderate in order to help protect exporters. His economic advisor, Francisco Iturralde made a point of adding how much the Central Bank was

suffering from the fall in the dollar. Only 12 percent of reserves are held in gold, with the remainder in U.S. dollars. Garron said that the Central Bank would begin to diversify, but cautiously. It is not only the Central Bank that is looking to sell dollars, private holdings of dollars have fallen dramatically. The IMF representative said that two years ago savings were 95 percent in dollars, that figure has now fallen to just 57 percent.

Improvised Economic Strategy, Incompetent and Political Management
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¶7. (C) The final consistent theme which emerged from the meetings was the Morales administration has yet to devise a consistent economic policy and the bureaucracy is both incompetent and overly political. The World Bank Resident Representative Oscar Avalle was particularly insightful as to how to handle the current administration. He said that the Bank and the government actually have a good working relationship and recently agreed on eight projects. The Bank has committed $300 million over the next 2-3 year period. Avalle, who came to Bolivia after working six years at the United Nations as part of the Argentine and then the Bank's mission at the United Nations, describes the government as obsessed with symbolism and an desire to always be the strongest member of the relationship. According to Avalle, being sensitive, patient, and always trying to bring things down to a more technincal level has paid dividends for his work at the Bank. However, he realizes and accepts that

trying to advise the government on an economic strategy is a non-starter.

¶8. (C) The level of politicization within the bureaucracy was made clear by Oscar Navarro, the recently resigned vice-minister at Treasury. When asked why he had resigned, he described a MAS takeover of the bureaucracy at the Ministry. By tradition within the Treasury, office directors are politically appointed. For the first year, the Morales administration contented itself with this level of control, but over that last year all of the lower-level unit chiefs have also been replaced by loyal Masistas. Navarro was the last non-MAS unit chief. He said that he was excluded from meetings and was even specifically directed not to meet with any international agencies. After 20 years in the government, it was time to leave.

¶9. (C) As an example of the level of mismanagement, Navarro talked about Treasury's relationship with the state hydrocarbon company (YPFB). When asked why YPFB rather than Treasury was paying for the diesel subsidies (which will likely be between $350-400 million in 2008), he said that it is because YPFB cannot demonstrate exactly what they paid for imported diesel: the Venezuelan state hydrocarbon company (PDVSA) does not give a receipt for the diesel delivered. Because of this, YPFB cannot document what it pays and cannot request reimbursement from Treasury. He also confirmed what is commonly believed in the hydrocarbon industry, that YPFB has no idea how much money flows through its bureaucracy.

Comment

¶10. (C) Taking political upheaval out of the equation, Bolivia appears set to lurch through another couple years of fragmented, ideologically-driven, economic mismanagement without suffering any severe short-term consequences. Inflation remains a threat (especially if diminishing production in the real sector accentuates the problem), but ultimately these bonanza times will probably allow the administration to pass on its economic mess to a new set of political leaders down the road.